



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201241012**

Release Date: 10/12/2012

Date: July 19, 2012

501.12-03

Legend:

Date A :

State B:

U :

Dear

We have considered your ruling request dated March 25, 2011, regarding the tax consequences of the proposed transaction described below.

You are exempt from federal income tax under section 501(c)(12) of the Code. You are an electric distribution cooperative incorporated on Date A under the laws of State B. You serve more than U homes, farms, businesses and industries in various counties in State B.

As a distribution cooperative, you purchase electric power under the all-requirement contracts with other power cooperatives, and deliver the power to your customers over your distribution lines. Due to significant economic growth in your service area, you have incurred substantial additional capital expenditures to serve your customers. You anticipate that further financings will be necessary to fund additional capital expenditures.

You have expressed concern that your continued operations as a tax-exempt entity will limit your ability to seek and obtain additional financing to fund your capital improvements. Thus, because you will need additional flexibility in the forms of financing utilized, you want to terminate your tax-exempt status under section 501(c)(12) of the Code.

In addition, you have stated that once "the Internal Revenue Service recognizes [your] status as a taxable cooperative, [you] need to remain taxable until such time as [you] seek and receive a determination letter from the Service that [you] again qualify as a tax-exempt entity." You have noted that "this is important in that the contemplated financing can be adversely affected by [your] classification as a tax-exempt entity."

Under State B's rural electric cooperative statute, only cooperative, nonprofit, membership corporations may be organized under that law. However, operation as a nonprofit membership corporation in State B is not dependent on the corporation's federal income tax classification.

Further, you have stated that your operation as a nonprofit cooperative does not determine your status for State B income tax purposes. Under the law of State B, a corporation for income tax purposes may include a cooperative, even though it is a nonprofit corporation. Therefore, you have concluded that if your tax-exempt status under section 501(c)(12) is terminated, you will be a cooperative taxable under both federal law and the law of State B.

You have requested the following ruling:

- (1) An organization exempt under section 501(c)(12) of the Internal Revenue Code can surrender its tax-exempt status and operate as a taxable cooperative through the filing of a final Form 990 return.

Law:

Section 501(c)(12) of the Code provides for the exemption from federal income tax of benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses. Mutual and cooperative electric companies are considered to be "like organizations" for these purposes. Rev. Rul. 67-265, 1967-2 C.B. 205.

Section 6043(b) of the Code provides that an organization which for any of the last five taxable years preceding liquidation, dissolution, termination, or substantial contraction was exempt from taxation under section 501(a) shall file a return and other information with respect to the liquidation, dissolution, termination, or substantial contraction as the Secretary of the Treasury may prescribe.

Rev. Rul. 65-99, 1965-1 C.B. 252, provides that the 85 percent member income test is applied on the basis of an annual accounting period. Failure to meet the requirement in a particular year precludes exemption for that year, but has no effect upon exemption for years in which the 85 percent test is satisfied. Specifically, if for any year the income received from a transaction, together with other nonmember income, causes the organization's income from members for the year to fall below 85 percent, the organization is required to file a corporation income tax return, Form 1120, for that year.

Rationale:

The income of certain cooperatives, including mutual and cooperative electric companies, is exempt from federal income tax as long as 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses. Section

501(c)(12). For any year that such an organization does not meet the 85 percent member income test, it is required to file a Form 1120 and pay income tax. However, it does not thereby lose its status under §501(c)(12), and its income will again be exempt from federal tax for the next year that it meets the 85 percent member income test. Rev. Rul. 65-99.

However, in order to obtain your needed financing, you cannot operate as an exempt entity, whether or not paying federal income tax. Thus, you wish to surrender your tax-exempt status under §501(c)(12). An organization that no longer wants to be exempt under §501(a) of the Code files a final return as described in §6043(b). In your case, this means a final Form 990. Once your final return is filed, you will no longer be described in §501(a) or §501(c)(12).

You have emphasized that you will become taxable under both federal and state law once you are no longer recognized as tax-exempt under §501(c)(12) of the Code.

Accordingly, based on the above, we rule as follows:

- (1) You, as an organization exempt under section 501(c)(12) of the Code, can surrender your tax-exempt status and operate as a taxable cooperative through the filing of a final Form 990 return.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Mary J. Salins
Manager, Exempt Organizations
Technical Group 4

Enclosure
Notice 437